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THE MAGAZINE FOR GROWING COMPANIES

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WHY DAUGHTERS ARE BETTER

Suddenly It's 'Daddy's Little Girl'. Who's Taking Over the Family Business

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WIDE OPEN SPACES

The real-estate glut is bad news for developers and lenders but good news for almost everybody else

BY DAVID L. BIRCH

In a Denver spa not long ago, I asked my steam-room compatriot (a Denver local) what he was paying for office space.

"Five cents a foot," he said.

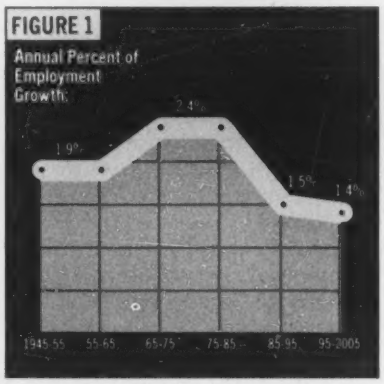
"Per year?" I asked incredulously.

"Per year," was the answer, and he had been out that day shopping for *a better deal*. How can that be? How can something costing $16 or $17 a year to operate sell for 5¢?

What my Denver friend has happily discovered is an example of the strange circumstances a major economic transition can produce. His particular case may be among the most extreme—but it's being repeated to some degree in almost every real-estate market in the country. There is a glut of office space at the end of a four-year period when demand for it has been extraordinarily strong. We should be out of office space by now, as we were in 1980 after the 1976–1980 boom. But we're not—not by a long shot. How did this happen, and what does it mean for all of us who own or lease space?

The explanation has to do with demographics—which, as we'll see, one ignores at one's peril. The story starts about 15 or 20 years ago when the war babies began to hit the labor force. Their arrival caused a huge bulge in the pace of employment growth, speeding it by 26%, beginning in the decade 1965–1975. A graph of the war baby employment influx (see figure 1) looks like the profile of a snake that has recently eaten a watermelon.

About half the war babies, of course, were women. But unlike their mothers, many of *these* women decided they wanted to work as well as raise families. From the immediate postwar years to 1985, the percentage of women who worked nearly doubled (see figure 2)—this at a time when the number of women available to work was rising as well.



Post–World War II baby boomers hit the labor market in the decade 1965–1975.

The office-space story is made richer by the fact that war babies of both sexes decided they didn't want to work in factories. Of the 38 million jobs added to the economy between 1966 and 1986, not one was in manufacturing. Most of the war babies wanted to work in offices. They wanted to join the service economy, wear white shirts, and become managers or clerks.

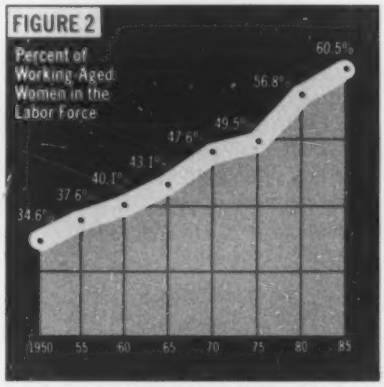
So we built them offices—at an extraordinary rate. Between 1975 and 1985 alone we built 36% of all office space ever built in the history of America. Since most of it was leased, since there was an enormous amount of money pouring in from swelling pension funds and from abroad (initially from Europe and the Middle East, more recently from Japan), and since the tax codes made it very profitable to build office space and even to hold it empty for a while—we kept on building.

In fact, we built far more than we needed at the time, because there always appeared to be some greater fool who would come along and take it off our hands. (The "greater fool" theory explains many economic follies of the past, and this one is no exception.) In general, one in five office buildings built between 1975 and 1985 was not needed. In the Mountain West it was almost one in two; in the Oil Patch, more than one in three; in the Pacific West, about one in three (see figure 3).

Vacancy rates began to soar even as employment growth continued. By 1985, about one out of every five office buildings in the country was empty. In some cities, the rate was much higher. It was 25% in Houston, 22% in Denver, 23% in Dallas, and 33% in Phoenix.

Then a new reality began to set in. In some places, it was worse than reality. The oil shock delivered blows to the economies of Houston, Dallas, Denver, Tulsa, and New Orleans, the likes of which they had never seen. To make matters worse, Congress revised the tax code last year, making it no longer desirable to lose money—quite a jolt to the real-estate industry.

At the same time, other, more pervasive, trends began to emerge. By 1985, the



CHARTS, NIGEL HOLMES

Office-space demand has been accelerated by the rising number of women who work.

watermelon was just about through the snake. Many women who had put off having children decided it was time to do so, and, in some cases, left the labor force. Employment growth began to slow down, and now is expected to slow even more—the rate for the next 10 years will be close to half what we've become used to. And my best guess is that the next 2 or 3 years in particular will be worse than that.

A study I did for Massachusetts Institute of Technology's Center for Real Estate Development predicts that during the next 10 years, under the most promising scenario, America will need to build only 50% as much office space as was built during the past 10. And however bad that sounds, it could be an understatement. The *Fortune* 500, from 1980 through 1986, reduced their employment by 2.8 million jobs—that's about the same as today's total work force in the commonwealth of Massachusetts, public and private. Most of those companies work with long-term leases that did not expire when they eliminated 2.8 million people. Now they are sitting on huge amounts of leased but empty space that is not counted in the vacancy statistics. A rough estimate suggests that these companies are holding enough vacant space to reduce the need for new construction in the next 10 years to *one-quarter* of its previous levels.

But construction hasn't stopped. It's slowed down, but not nearly enough. Buildings going up today were designed, financed, zoned, and committed to several years ago. Like turning around the *Queen*

Mary, stopping the office-construction industry takes a long time. The result? Buildings are actually declining in value. Average rents in buildings that break even at $16 or $17 a foot are $7.50 a foot in some Oil Patch cities. My Denver friend's rent, to come full circle, was down to 5¢ a foot—and he was searching. Even so, things will get worse before they get better.

For those of us who are tenants (and that's most of us), the overbuilding of office space is a real bonanza. You may not be able to do as well as the folks in Denver, but with even a modest amount of shopping you should be able to reduce your current rent, obtain free rent for several months, obtain substantial tenant improvements at no cost, and lock in attractive options on adjacent space so that you won't have to disrupt your company as you grow. This is a particularly good time to start a company in such a place as Houston, since you probably can live rent-free for a year or more. I was told of one lease in Dallas where the tenant's sole financial obligation for 200,000 square feet of new space over a five-year period was to keep the lights on until 11 p.m. and post a guard.

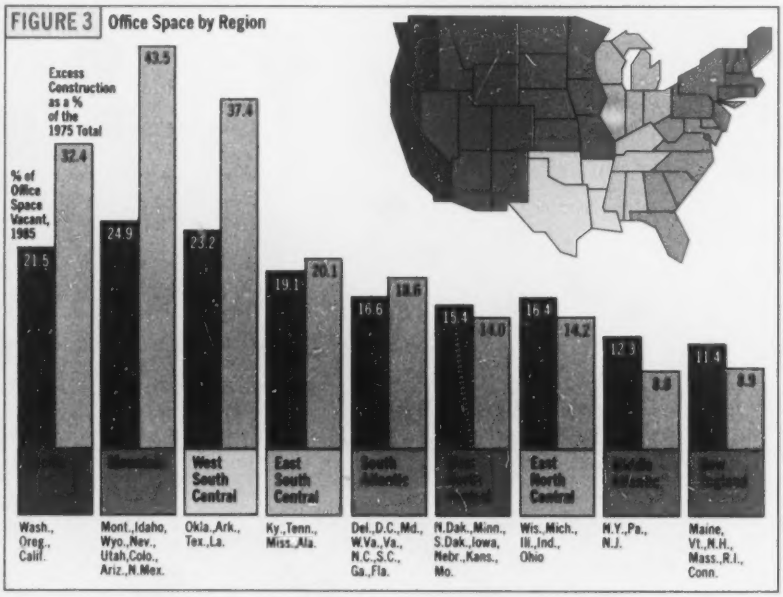
For prospective buyers, too, times are great. The main consideration—as continued construction in a slowing economy depresses the market further—is timing. The banks are just beginning to feel the pinch, as their real-estate portfolios shrink in value. The next 12 to 18 months could be an excellent time to acquire either a building or a long-term lease on very attractive terms.

Then there are the people who build and sometimes own buildings: many growing businesses, and many readers of INC., are developers. If you are one of them, your mission is clear. The time has come to switch from developing to managing. There are a few new buildings to be built, but not many, and everyone will be wanting to build them. Your main focus will have to be on managing better what you already have. You will have to figure out who needs your space—mostly smaller, growing businesses. You will have to find those companies—which is tough, because they're spread all over the place. And you will have to keep them happy. You'll have to offer them the day-care facilities, fitness centers, responsive building management, and aesthetics that they seek and—under the current circumstances—can demand. It will not be an easy time to be a developer.

Any major shift in the economy offers opportunities and causes problems. The oil shock hurt some cities and states badly, but helped the majority of us by lowering oil prices and keeping inflation under control. So it is with the overbuilding of office space nationwide. Some developers and banks and insurance firms will be harshly punished. The majority of us, though, will have an opportunity, over the next year, to acquire inexpensive office space under terms unparalleled in recent history. From our perspective, it couldn't be a better time to start and grow a company. □

David L. Birch is president of Cognetics Inc. and director of MIT's Program on Neighborhood and Regional Change.

FIGURE 3 **Office Space by Region**



Between 1975 and 1985, builders erected 36% of all office space ever constructed in the history of America. Now, there is too much.

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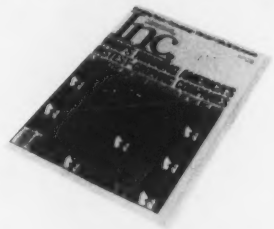

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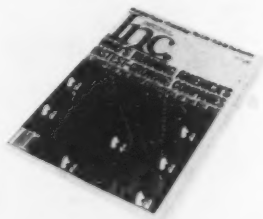

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SMALL COMPANY INITIAL PUBLIC OFFERINGS: MAY 1987

O-T-C sym.	Company	Business/product	Offering Size ($mil.)	Offering Price	First aftermarket bid	Underwriter
JETS	Jetborne International	Aviation support svcs.	3.75	3.75	4	Werbel-Roth
KMAG	Komag	Dvlps., mfrs., & mkts. thin-film disks	37.62	12.00	12¾	Robertson Colman
LMG[b]	Lawson Mardon Group	Produces flexible packaging	50.84	11.91[i]	11⅜	Merrill Lynch
LTIZ	Liposome Technology	Produces liposomes for pharm. applications	21.00	12.00	12	Montgomery Securities
MGI[a]	MFS Government Markets Income Trust	Closed-end mgmt. investment co.	850.00	10.00	10	Wheat First
MF[a]	Malaysia Fund	Closed-end mgmt. investment co.	84.00	12.00	12	Merrill Lynch
MTCIU	Management Technologies	Dvlps. & mkts. bank software	4.20	6.00[h]	6	D. H. Blair
MIKL	Michael Foods	Produces, processes, & distr. food prods.	32.00	16.00	16½	William Blair
MNPI	Microcom	Mkts. & svcs. data-comm. prods.	17.00	17.00	17¼	Salomon Brothers
MGC[a]	Morgan Grenfell SMALLCap Fund	Closed-end mgmt. investment co.	50.00	10.00	9¾	Wedbush Nobel
NIAM	National Imaging	Owns & operates tomography scanning systs.	5.23	5.50	5¼	First United Securities
NELL	Nellcor	Mfrs. medical monitoring equip.	38.40	16.00	16¾	Goldman Sachs
NJST	New Jersey Steel	Owns & operates steel mill	36.90	20.50	20½	Paine Webber
ONPR	One Price Clothing Stores	Operates women's clothing stores	15.00	15.00	16¾	Alex. Brown
OSBN	Osborn Communications	Operates radio & TV stations	8.00	8.00	8	E. F. Hutton
PSBX	Peoples Savings Bank FSB	Savings bank	7.65	11.00	11	Oppenheimer
PYE	Progressive Income Equity	Closed-end mgmt. investment co.	50.00	10.00	10	Edward D. Jones
RARB	Raritan Bancorp	Bank holding co.	2.35	10.00	10	Ryan Beck
RTP[a]	Reich & Tang L.P.	Investment mgmt. svcs.	33.00	15.00	15	Lazard Freres
SAFM	Sanderson Farms	Processes & mkts. chicken and other food prods.	16.10	14.00	14	Smith Barney
SHE[a]	Shearson Lehman Brothers Holdings	Securities firm	476.00	34.00	34	Shearson Lehman
LIPSU	Showcase Cosmetics	Packages, distr., & mkts. cosmetics	3.00	5.00[f]	5	D. H. Blair
SGDN	Surgidyne	Designs, dvlps., & mkts. surgical prods.	2.25	2.00	2⅜	Westonka Investments
TOPP	Topps, The	Produces bubble gum & collectible cards	22.10	13.00	13	Goldman Sachs
TIF[a]	Tiffany & Co.	Retails jewelry	80.50	23.00[k]	23	Shearson Lehman
TONS	Tons of Toys	Operates toy supermarkets	5.20	4.00	4	McKinley Allsopp
WBNC	Washington Bancorp	Bank holding co.	6.25	10.50	10½	Ryan Beck
WFSB	Washington Federal Savings Bank	Savings bank	1.76	10.00	10	Merrill Lynch
WHOO	Waterhouse Investor Services	Brokerage svc. holding co.	7	7.00	7¾	McKinley Allsopp

Initial public offerings sold at $1 or less not included; issues without underwriters not included. First aftermarket bid is approximate. [a] trading on NYSE, [b] trading on AMEX, [c] additional 1.1 million shares were offered overseas; [d] units of 1 common + 1 warrant; [e] units of 5 common + 2 warrants; [f] additional 700,000 shares were offered overseas; [g] additional 1.25 million shares were offered overseas; [h] units 2 common + 1 warrant; [i] additional 6.03 million shares were offered in Canada and 5.01 million shares were offered overseas; [j] units of 4 common + 4 warrants; [k] additional 1 million shares were offered overseas. Offering data source: *GOING PUBLIC: THE IPO Reporter*, a publication of The Dealer's Digest Inc., 150 Broadway, New York, NY 10038.

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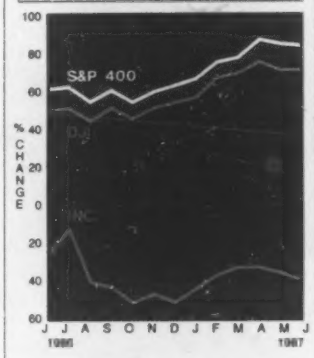
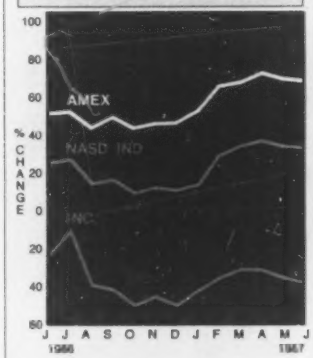


All averages start at 0 on May 1, 1982.

INC. vs. SPECULATIVE AVERAGES



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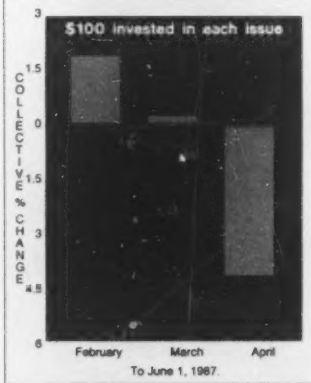
IPOs IN THE AFTERMARKET



To June 1, 1987.

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SODA	**A & W Brands**	Mfrs., mkts., & distr. soft-drink concentrates	37.40	11.00	10⅞	First Boston
ALS[a]	**Allegheny Ludlum**	Mfrs. steel	129.13	25.00[c]	27½	Goldman Sachs
AMMT	**American Medical Technology**	Assembles medical-procedure packs	3.35	5.00	5	Buchanan
ASCRU	**American Screen**	Dvlps. & distr. motion pictures	3.00	3.00[d]	3	Mostel & Taylor
VOX[b]	**Audiovox**	Mkts. & distr. auto accessories	40.40	16.00	15⅜	Donaldson Lufkin
BMCC	**Bando McGlocklin Capital**	Small-business investment co.	4.78	6.38	6⅜	Milwaukee Co.
BAYCU	**Bay Area Recovery Centers**	Provides home health svcs.	3.75	7.50[e]	8½	Reich & Co.
BNP[b]	**Boddie-Noell Restaurant Properties**	Owns restaurants	31.20	12.00	11¾	Alex. Brown
BOYS	**Boys Markets**	Operates supermarkets	14.35	10.25	10	Merrill Lynch
BDGT	**Budget Rent A Car**	Car and truck rental	35.00	14.00[f]	14	First Boston
CNBKA	**Century Bancorp**	Bank holding co.	11.40	7.13	7	Moseley Securities
CPX[a]	**Cineplex Odeon**	Operates motion-picture theaters	25.92	14.81	14	Merrill Lynch
CSOLU	**Convergent Solutions**	Dvlps. & mkts. computer software	3.50	2.00[d]	5¾	Fitzgerald DeArman
CXIM	**Criticare Systems**	Mfrs. patient-monitoring systs.	7.35	5.25	5¾	Steinberg & Lyman
CMBK	**Cumberland Federal Savings Bank**	Savings bank	20.64	10.25	10¼	Drexel Burnham
DTCI	**Data Technology**	R&D & mkts. storage controllers	22.33	11	12	Hambrecht & Quist
DMIC	**Digital Microwave**	Designs, mfrs., & mkts. comm. prods.	27.75	15	15¾	Goldman Sachs
TOOL	**Easco Hand Tools**	Mfrs. mechanic & auto tools	35.75	11[g]	10½	Paine Webber
ENVI	**Envirosafe Services**	Hazardous-waste mgmt.	20.25	15.00	15	Robinson-Humphrey
FFP[b]	**FFP Partners L.P.**	Acquires gas outlets & convenience stores	24.00	12.00	12	Donaldson Lufkin
FBNC	**First Bancorp**	Bank holding co.	7.10	17.75	17¾	Interstate Securities
MTCL	**First National Bank**	Savings bank	3.05	21.75	21¾	Ryan Beck
GPAK	**Graphic Packaging**	Produces & sells flexible packaging	12.08	10.50	10¾	William Blair
HCCC	**HealthCare COMPARE**	Provides health-care mgmt. svcs.	13.20	11	11.5	Montgomery Securities
HIRSU	**High Resolution Sciences**	Dvlps. comm. technologies	3.00	6.00[h]	6	D. H. Blair
HHC[a]	**Horizon Healthcare**	Operates health-care facilities	21.60	8.00	8	Thomson McKinnon
JAYJ	**Jay Jacobs**	Owns retail specialty stores	18.00	12.00	11⅛	Alex. Brown

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INITIAL PUBLIC OFFERINGS (continued on page 110)

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